United Nations A/CN.9/WG.VI/WP.63/Add.3

General Assembly

Distr.: Limited
6 February 2015

Original: English

United Nations Commission on International Trade Law
Working Group VI (Security Interests)
Twenty-seventh session
New York, 20-24 April 2015

Draft Model Law on Secured Transactions

Note by the Secretariat

Addendum

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Chapter VIII. Conflict of laws[1]

A. General rules

Article 95. Law applicable to the rights and obligations of the grantor and the secured creditor

The law applicable to the mutual rights and obligations of the grantor and the secured creditor arising from their security agreement is the law chosen by them and, in the absence of a choice of law, by the law governing the security agreement.

[*Note to the Working Group: The Working Group may wish to note that the Guide to Enactment will make reference to international texts dealing with the law applicable to contractual rights and obligations, including the Hague Principles on Choice of Law in International Contracts.*]

Article 96. Law applicable to a security right in a tangible asset

1. Except as provided in paragraphs 2 to 4 and article 110, the law applicable to the creation, effectiveness against third parties, and priority of a security right in a tangible asset is the law of the State in which the asset is located.

2. The law applicable to the creation, third-party effectiveness and priority of a security right in a tangible asset of a type ordinarily used in more than one State is the law of the State in which the grantor is located.

3. If a notice with respect to security right in a tangible asset is registered in [the enacting State to specify a specialized registry, if any] or the security right is noted on [the enacting State to specify a title certificate, if any], the law applicable to the creation, third-party effectiveness and priority of a security right in a tangible asset is the law of the State under whose authority the registry is maintained or the certificate is issued.

4. The law applicable to the priority of a security right in a tangible asset made effective against third parties by possession of a negotiable document as against a competing security right made effective against third parties by another method is the law of the State in which the document is located.

5. A security right in a tangible asset (other than a negotiable instrument) in transit or to be exported from the State in which it is located at the time of the creation of the security right may be created and made effective against third parties under the law of the State of the location of the asset at the time of creation as provided in paragraph 1, or under the law of the State of the asset's ultimate destination, provided that the asset reaches that State within [a short period of time, such as 30 days, to be specified by the enacting State] after the time of creation of the security right as provided in paragraph 1.

[*Note to the Working Group: The Working Group may wish to note that the Guide to Enactment will explain that paragraph 3 has been revised to ensure that a*

[1] The enacting State may implement the conflict-of-laws provisions as part of the secured transactions law (at the beginning or at the end of it) or as part of a separate law (civil code or other law).

law other than the law of the location of the asset will apply only if a notice with respect to a security right has been actually registered in a specialized registry or a notation with respect to the security right has been made on a title certificate, and not only if, as a matter of principle, a notice could be registered or a notation made, as provided in recommendation 205 of the Secured Transactions Guide, *on which this provision is based. The Guide to Enactment will also explain that paragraph 3 will lead to the application of the law other than the tangible asset if the asset is located in one State and a notice is registered in a specialized registry maintained under the authority of another State or a security right is noted on a certificate issued in another State. With respect to the relevant time for determining location, the Guide to Enactment will also include a cross-reference to article 102. The Working Group may wish to consider whether paragraph 5, which is based on recommendation 207 of the* Secured Transactions Guide, *is a conflict-of-laws rule rather than a substantive rule of the receiving State like article 21 (see A/CN.9/WG.VI/WP.63).]*

Article 97. Law applicable to a security right in an intangible asset

[Subject to articles 98 and 107-110, the] [The] law applicable to the creation, effectiveness against third parties and priority of a security right in an intangible asset is the law of the State in which the grantor is located.

Article 98. Law applicable to a security right in receivables arising from a sale, lease or security agreement relating to immovable property

1. The law applicable to the creation, effectiveness against third parties and priority of a security right in a receivable arising from a sale, lease or security agreement relating to immovable property is the law of the State in which the grantor is located.

2. Notwithstanding paragraph 1, the law applicable to the priority of a security right in a receivable as against the right of a competing claimant that is registered in an immovable property registry is the law of the State under whose authority the registry is maintained, provided that under that law, registration is relevant to the priority of the security right in the receivable.

Article 99. Law applicable to the enforcement of a security right

The law applicable to issues relating to the enforcement of a security right:

(a) In a tangible asset is the law of the State where [the relevant act of] enforcement takes place; and

(b) In an intangible asset is the law applicable to the priority of the security right.

[Note to the Working Group: The Working Group may wish to consider the text within square brackets in subparagraph (a), which is intended to clarify that enforcement may involve several acts, such as a notice of default, notice of extrajudicial repossession and disposition of an encumbered asset, disposition, and distributions of proceeds of disposition (see A/CN.9/802, para. 105). Alternatively, the matter may be discussed in the Guide to Enactment. With respect to subparagraph (b), the Working Group may wish to consider whether its application

together with article 102 leads to the appropriate result. In this regard, the Working Group may wish to note that, under a combined application of subparagraph (b) and article 102, if the grantor moved since the security right was created and, thus the law applicable to priority changed, the rights of the secured creditor on default would also change, even if the secured creditor did not consent to the move or even did not know about it. The Working Group may wish to note that, if the grantor moved during the enforcement process and only at that time a priority issue arose, the law applicable would again change (see also note to article 102).]

Article 100. Law applicable to a security right in proceeds

1. The law applicable to the creation of a security right in proceeds is the law applicable to the creation of the security right in the original encumbered asset from which the proceeds arose.

2. The law applicable to the third-party effectiveness and priority of a security right in proceeds is the law applicable to the third-party effectiveness and priority of a security right in an asset of the same kind as the proceeds.

[*Note to the Working Group: The Working Group may wish to note that the Guide to Enactment will explain that, in accordance with paragraph 1, which is based on recommendation 215, subparagraph (a), of the* Secured Transactions Guide, *if the original encumbered asset is inventory, which is sold and a receivable is generated, which in turn is paid into a bank account, the law applicable to the creation of the security right in the bank account as proceeds of the original encumbered inventory would be the law of the location of the inventory. In that case, the law applicable to the third-party effectiveness and priority of the security right would be the law applicable to bank accounts (see article 107 below).*]

Article 101. Meaning of "location" of the grantor

1. For the purposes of the provisions of this chapter, the grantor is located in the State in which it has its place of business.

2. If the grantor has a place of business in more than one State, the grantor's place of business is that place where the central administration of the grantor is exercised.

3. If the grantor does not have a place of business, reference is to be made to the habitual residence of the grantor.

Article 102. Relevant time for determining location

1. Except as provided in paragraph 2, references to the location of the encumbered asset or of the grantor in the provisions of this chapter refer, for creation issues, to the location at the time of the putative creation of the security right and, for third-party effectiveness and priority issues, to the location at the time the issue arises.

2. If the rights of all competing claimants in an encumbered asset are created and made effective against third parties before a change in location of the asset or the grantor, references in the provisions of this chapter to the location of the asset or of

the grantor refer, with respect to third-party effectiveness and priority issues, to the location prior to the change in location.

[*Note to the Working Group: The Working Group may wish to consider whether article 102 should provide guidance with respect to the relevant time for determining location for the purpose of enforcement issues. For example, the relevant time for determining location of the encumbered asset or the grantor for enforcement issues should be the time of the location of the asset or the grantor at the time of putative creation.*]

Article 103. Exclusion of *renvoi*

A reference in the provisions of this chapter to "the law" of another State as the law applicable to an issue refers to the law in force in that State other than its conflict-of-laws provisions.

Article 104. Overriding mandatory rules and public policy (*ordre public*)

1. The provisions of this chapter do not prevent a court from applying overriding mandatory provisions of the law of the forum which apply irrespective of the law applicable under the provisions of this chapter.

2. The law of the forum determines when a court may or must apply or take into account overriding mandatory provisions of another law.

3. A court may only exclude the application of a provision of the law applicable under the provisions of this chapter if and to the extent that the result of such application would be manifestly incompatible with fundamental notions of public policy (*ordre public*) of the forum.

4. The law of the forum determines when a court may or must apply or take into account the public policy (*ordre public*) of a State the law of which would be applicable under the provisions of this chapter.

5. Paragraphs 1 and 3 do not permit the application of the provisions of the law of the forum to the third-party effectiveness and priority of a security right.

[*Note to the Working Group: The Working Group may wish to note that articles 103 and 104 of the draft Model Law have been revised to be aligned with articles 8 and 11 of the Hague Principles on Choice of Law in International Contracts (see A/CN.9/802, para. 106).*]

Article 105. Impact of commencement of insolvency proceedings on the law applicable

1. Subject to paragraph 2, the commencement of insolvency proceedings does not displace the provisions of this chapter.

2. The rule in paragraph 1 is subject to the effects on such issues of the application of the insolvency law of the State in which insolvency proceedings are commenced to issues such as avoidance, treatment of secured creditors, ranking of claims or distribution of proceeds.

[*Note to the Working Group: The Working Group may wish to consider whether this article should be retained, in view of the fact that the draft Model Law*

does not deal with substantive insolvency issues (or the law applicable in the case of the grantor's insolvency).]

B. Asset-specific rules

Article 106. Law applicable to the relationship of third-party obligors and secured creditors

The law applicable to a receivable, negotiable instrument or negotiable document also is the law applicable to:

(a) The relationship between the debtor of the receivable and the secured creditor, and the relationship between the obligor under a negotiable instrument and the holder of a security right in the instrument;

(b) The conditions under which a security right in a receivable, a negotiable instrument or negotiable document may be invoked against the debtor of the receivable, the obligor under a negotiable instrument or the issuer of a negotiable document, including whether an agreement limiting the grantor's right to create a security right may be asserted by the debtor of the receivable, the obligor under the negotiable instrument or the issuer of the negotiable document; and

(c) Whether the obligations of the debtor of the receivable, the obligor under the negotiable instrument or the issuer of the negotiable document have been discharged.

[*Note to the Working Group: The Working Group may wish to note that this article is based on recommendation 217 of the* Secured Transactions Guide.]

Article 107. Law applicable to a security right in a right to payment of funds credited to a bank account

1. Subject to article 108, the law applicable to the creation, effectiveness against third parties, priority and enforcement of a security right in a right to payment of funds credited to a bank account, as well as rights and duties of the depositary bank with respect to the security right, is

Alternative A[2]

The law of the State in which the bank with which the account is maintained has its place of business.

2. If the bank has places of business in more than one State, reference should be made to the place where the branch maintaining the account is located.

Alternative B

The law of the State expressly stated in the account agreement as the State whose law governs the account agreement or, if the account agreement expressly provides that another law is applicable to all such issues, that other law.

[2] A State may adopt alternative A or alternative B of this article.

2. The law of the State determined pursuant to paragraph 1 applies only if the depositary bank has, at the time of the conclusion of the account agreement, an office in that State that is engaged in the regular activity of maintaining bank accounts.

3. If the applicable law is not determined pursuant to paragraph 1 or 2, the applicable law is to be determined pursuant to [the default rules based on article 5 of the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary].

[*Note to the Working Group: The Working Group may wish to note that this article is based on recommendation 210 of the* Secured Transactions Guide.]

Article 108. Law applicable to the third-party effectiveness of a security right in specified types of asset by registration

If the State in which the grantor is located recognizes registration as a method for achieving effectiveness against third parties of a security right in a negotiable instrument or a right to payment of funds credited to a bank account, the law of that State is the law applicable to the issue whether third-party effectiveness has been achieved by registration under the laws of that State.

[*Note to the Working Group: The Working Group may wish to note that this article is based on recommendation 211 of the* Secured Transactions Guide. *The Working Group may wish to consider whether this rule should apply even if a notice with respect to a security right has not been actually registered in the general security rights registry of the grantor's State. The Working Group may also wish to consider whether this rule should apply only to negotiable instruments and rights to payment of funds credited to bank accounts or also to other types of asset (e.g. tangible assets, the third-party effectiveness of a security right in which would be determined by the location of the instrument).*]

Article 109. Law applicable to a security right in intellectual property

1. The law applicable to the creation, effectiveness against third parties and priority of a security right in intellectual property is the law of the State in which the intellectual property is protected.

2. A security right in intellectual property may also be created under the law of the State in which the grantor is located and may also be made effective under that law against third parties other than another secured creditor, a transferee or a licensee.

3. The law applicable to the enforcement of a security right in intellectual property is the law of the State in which the grantor is located.

Article 110. Law applicable to a security right in non-intermediated securities

Option A

1. Subject to paragraph 2:

(a) The law applicable to the creation, third-party effectiveness and priority of a security right in certificated non-intermediated securities is the law of the State in which the certificate is located; and

(b) The law applicable to the enforcement of a security right in certificated non-intermediated securities is the law of the State in which enforcement takes place.

2. The law applicable to the effectiveness of a security right in certificated non-intermediated securities against the issuer is the law of the State under which the issuer is constituted.

3. The law applicable to the creation, the effectiveness against third parties, the priority and the enforcement of a security right in uncertificated non-intermediated securities, as well as to its effectiveness against the issuer, is the law of the State under which the issuer is constituted.

Option B

The law applicable to the creation, the effectiveness against third parties, the priority and the enforcement of a security right in non-intermediated securities, as well as to its effectiveness against the issuer, is the law of the State under which the issuer is constituted.

Option C

1. The law applicable to the creation, the effectiveness against third parties, the priority and the enforcement of a security right in non-intermediated equity securities, as well as to its effectiveness against the issuer, in the law under which the issuer is constituted.

2. The law applicable to the creation, the effectiveness against third parties, the priority and the enforcement of a security right in non-intermediated debt securities, as well as to its effectiveness against the issuer, is the law governing the securities.

[*Note to the Working Group: The Working Group may wish to consider the above options. Option A provides separate rules for certificated and uncertificated securities and, with respect to certificated securities, different rules for the various matters (which are the same rules as those applicable to tangible assets; see articles 96, para. 1 and 99, subpara. (a)). In particular with respect to certificated securities, this approach has the advantage of flexibility but also the disadvantage of uncertainty as it may lead to inconsistencies and overlaps. For example, some creation, third-party effectiveness and enforcement issues may be viewed as issues relating to the effectiveness against the issuer (this is the reason why paragraph 1 is subject to paragraph 2) and thus may be referred to the law of the issuer's constitution rather than the law of the certificate's location. In addition, by referring the creation, third-party effectiveness and priority of a security right in certificated securities to the law of the certificate's location, option A makes it possible for the secured creditor to manipulate the law applicable by moving the certificate from one country to another. With respect to uncertificated securities, option A has the advantage that only one rule would apply to all issues and refer to one and the same law (which is though different from the law applicable to other types of intangible asset). It has, however, the disadvantage that it does not draw a distinction between equity securities (with respect to which the law of the State of the constitution of the issuer is appropriate) and debt securities (with respect to which, the law of the State of the constitution of the issuer may not be always appropriate).*

Option B provides one single rule that would apply to both certificated and uncertificated securities and to all issues, namely, the effectiveness against the issuer, the creation, the effectiveness against third parties, the priority and the enforcement of a security right. This approach eliminates the risks of inconsistencies or overlaps between the law of the State of issuer's constitution (which should always apply to the effectiveness against the issuer) and another law that the conflict-of-laws rules of the forum may designate for other issues (e.g. the law of the location of the certificate for the priority of a security right in certificated non-intermediated securities). In addition, referring to only one law for all issues provides greater certainty, as some matters (e.g. limitations on the transfer of securities under corporate law) may be viewed as being relevant not only to the effectiveness of the security right against the issuer but also to its creation and its enforcement. Moreover, by not referring to the law of the location of the certificate with respect to certificated securities, option B prevents the secured creditor from manipulating the designation of the applicable law by moving the certificate from one country to another. The disadvantage of option B, however, is that it departs from the lex situs rule for the creation, effectiveness against third parties and priority of a security right in certificated securities. Thus, the conflict-of-laws rules for certificated securities would then be different from those applicable to other intangible assets that have been assimilated for certain purposes to tangible assets (under article 100, the creation, effectiveness against third parties and priority of a security right in negotiable documents or instruments are governed by the law of the location of the document or instrument).

Option C retains option B for equity securities (whether certificated or uncertificated) but refers to a different rule for debt securities (whether certificated or uncertificated), that is, the law of the State governing the securities to govern all issues. The justification for that approach is that, if the issuer has selected a law other than the law of the State of its constitution as the governing law of the securities, that other law should also be the law applicable to security right matters. The benefit of this approach is that one single law would govern all matters relating to debt securities, which would avoid the risks of inconsistencies arising from different laws being applicable to the various issues. The disadvantage of option C, however, is that the distinction between equity securities and debt securities may be blurred in certain circumstances (e.g. convertible securities). In addition, while option C focusses on the contractual nature of debt securities, which are analogous to receivables in that respect, it would not be consistent with the conflict-of-laws rule on the creation, effectiveness against third parties and priority of a security right in a receivable (under article 97, in the case of a receivable, the law of the State in which the grantor is located would govern those issues). As debt securities are receivables in a generic sense (monetary obligations), then a variation of option C would be to apply to debt securities the same conflict-of-laws rule as for receivables.]

Article 111. Law applicable in the case of a multi-unit State

1. If the law applicable to an issue is the law of a multi-unit State, subject to paragraph 3, references to the law of a multi-unit State are to the law of the relevant territorial unit and, to the extent applicable in that unit, to the law of the multi-unit State itself.

2. The relevant territorial unit referred to in paragraph 1 is to be determined on the basis of the location of the grantor or of the encumbered asset, or otherwise under the provisions of this chapter.

3. If the applicable law is that of a multi-unit State or one of its territorial units, the internal conflict-of-laws provisions in force in the multi-unit State or territorial unit determine whether the substantive provisions of law of the multi-unit State or of a particular territorial unit of the multi-unit State apply.

[*Note to the Working Group: The Working Group may wish to consider whether paragraph 3, which is drawn from recommendation 225 of the* Secured Transactions Guide *means that: (a) the conflict-of-laws rules in the relevant State or unit determine whether to apply the laws of the State (as a whole) or only a territorial unit; or (b) the conflict-of-laws rules in the State or territorial unit determine whether to apply the law of a different territorial unit in the State. If it is the latter, it means that the forum State is required to master the internal conflict-of-laws rules of the State of the location of the grantor or the encumbered asset; so, it is a semi-renvoi. The Working Group may wish to note that in this regard the* Assignment Convention *allows a declaration by States as to the determination of the applicable priority rule as between various territorial units, but here there would be no declaration and the forum would be on its own to figure things out under the conflict-of-laws rules of another State.*]

IX. Transition

Article 112. General

1. This Law comes into force on [a date to be specified by the enacting State] [[...] months after a date to be specified by the enacting State].

2. This Law [repeals] [abrogates] [overrides] [modifies] the [laws to be specified by the enacting State].

3. For the purposes of this chapter:

(a) "Prior law" refers to the law of the enacting State that was in force immediately prior to the date on which this Law comes into force; and

(b) "Prior security right" means a right created before the date on which this Law comes into force that is a security right within the scope of this Law and to which this Law would have applied if it had been in force at the time when it was created.

4. This Law applies to all security rights within its scope, including prior security rights, except to the extent that this chapter provides for the continued application of prior law.

Article 113. Actions commenced before the date on which the Law comes into force

Prior law applies to:

(a) Disputes with regard to the post-default rights and obligations of the grantor and the secured creditor that are the subject of court or arbitral tribunal

proceedings that were commenced before the date referred to in article 112, paragraph 1; and

(b) Disputes with regard to the post-default rights and obligations of the grantor and the secured creditor that are the subject of out-of-court proceedings if [notice of default] [notice of extrajudicial repossession] [notice of extrajudicial sale] [distribution of proceeds] [the step to be specified by the enacting State] has occurred before the date referred to in article 112, paragraph 1.

[*Note to the Working Group: The Working Group may wish to note that the Guide to Enactment will explain that what step exactly (e.g. the submission of a claim) constitutes commencement, in the case of judicial or arbitral proceedings, will be a matter of civil procedure law. The Working Group may wish to consider whether what exactly constitutes commencement in the case of extrajudicial proceedings should be addressed in the draft Model Law or left to each enacting State.*]

Article 114. Creation of a security right

1. Prior law determines whether a security right was created before the date referred to in article 112, paragraph 1.

2. A prior security right remains effective between the parties under this Law [notwithstanding that it does not comply with the creation requirements of this Law].

[*Note to the Working Group: The Working Group may wish to consider whether the bracketed text is necessary.*]

Article 115. Third-party effectiveness of a security right

1. A prior security right that was made effective against third parties before the date referred to in article 117, paragraph 1, in accordance with prior law continued to be effective against third parties under this Law until the earlier of:

(a) The time it would have ceased to be effective against third parties under prior law; and

(b) The expiration of [a transition period, such as six months, to be specified by the enacting State] after the date on which this Law enters into force.

2. [A security agreement [or other method of creation under the old law to be specified by the enacting State] entered into before the date referred to in article 112, paragraph 1, is sufficient as authorization for registration after the date referred to in article 112, paragraph 1.]

3. If the third-party effectiveness requirements of this Law are satisfied before third-party effectiveness would have ceased in accordance with paragraph 1, the prior security right continues to be effective against third parties for the purposes of this Law.

4. After the period of time referred to in paragraph 1, third-party effectiveness of a security right lapses and may be re-established if the third-party effectiveness requirements of this Law are satisfied.

Article 116. Priority of a security right

1. The time to be used for determining priority of a prior security right is the time it was made effective against third parties or, in the case of advance registration, became the subject of a registered notice under the prior law.

2. The priority of a prior security right is determined by prior law if:

(a) The security right and the rights of all competing claimants arose before the date referred to in article 112, paragraph 1; and

(b) The priority status of none of these rights has changed since the date referred to in article 112, paragraph 1.

3. The priority status of a security right has changed only if:

(a) It was effective against third parties on the date referred to in article 112, paragraph 1, in accordance with article 115, paragraph 1, and ceased to be effective against third parties as provided in article 115, paragraph 4; or

(b) It was not effective against third parties under prior law on the date referred to in article 112, paragraph 1, and was made effective against third parties under this Law.